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Thomas Lum
Specialist in Asian Affairs

Within the next ten years, China (PRC) is expected to have a significant market for passenger cars. China's accession to the World Trade Organization (WTO) and permanent normal trade relations (PNTR) status would promise to open this market to foreign trade and investment. However, American automobile and parts manufacturers face several obstacles in their efforts to gain market share in China. First, American companies in China, such as General Motors and DaimlerChrysler, face stiff competition from German, Japanese, and Korean producers. Second, although the PRC pledges to reduce or eliminate tariffs, quotas, and local content requirements and grant foreign car companies greater distribution and financing rights, Chinese central and local governments may still find ways to protect domestic companies and facilitate Chinese production of cars. This report may be updated as warranted.

WTO Provisions

The U.S.-China bilateral WTO agreement and WTO member requirements, if carried out, would heavily impact the Chinese auto sector. A Chinese investment journal reports that China's automobile industry would be the sector most affected by WTO membership since it is currently one of the most protected.[1] The following changes would apply to the Chinese auto industry if China enters the WTO and the United States grants China PNTR status. Upon accession to the WTO, China has agreed to reduce tariffs on imported cars from 80-100% to 25% and on auto parts from 40-50% to 10% by 2006.[2] Import quotas would be phased out by 2005. According to other WTO rules, discriminatory "value-added taxes" would be prohibited and domestic content requirements, now 40% or greater, would be eliminated. Foreign car companies would be granted financing and distribution rights.[3]

China's Passenger Car Market

China's 13 major auto manufacturers reportedly built 1.5-1.7 million motor vehicles in 1999. Chinese industry analysts estimate that in 2000, Chinese automobile manufacturers will produce 650,000 passenger cars and import 60,000 passenger cars or sedans, including both luxury cars and compacts.[4] In 1998, China imported only 20,000 cars. According to some reports, in the mid-1990s, nearly 90,000 cars per year were smuggled into China. The Chinese government curbed this trade by 1998, thereby reducing the proportion of imported cars.[5] In the first half of 2000, imports of cars, trucks, and buses were up in cities such as Shanghai, which reported an 85% increase over the same period in 1999. Japanese vehicles represented 64% of Shanghai imports; the remainder came from Germany, South Korea, and the United States.[6]

Foreign Investment and Market Shares

The top three Chinese automobile manufacturers – First Auto Works, Tianjin Automobile Industrial Group, and Shanghai Automotive Industrial Corporation – are involved in Chinese-foreign joint venture enterprises which account for over 80% of domestic production. Volkswagen (VW) and Toyota joint ventures dominate auto sales in China; in 1998 they held 58% and 18% of the market, respectively.[7] VW's Shanghai plant produces over 230,000 "Santana" models per year (priced at $25,000). The remainder of the Chinese auto market is served by other European, Japanese, Korean, American, and Chinese manufacturers. The U.S. share of the Chinese sedan market is estimated to be roughly 8% and growing. Its share of imported cars is less than 4%. In

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[1] "How WTO Membership Could Affect China's Auto Industry," *ChinaOnline*, January 5, 2000. http://www.chinaonline.com

[2] The largest reductions will occur in the first years after accession. "The U.S.-China Bilateral Agreement and the United States," *The China Business Review*, January-February 2000, p. 21.

[3] China reportedly has not yet removed or adjusted its 50% cap on foreign equity in automobile production enterprises. However, the PRC has allowed majority foreign ownership in automotive parts production. James B. Treece, "WTO Bid Grabs Beijing Spotlight," Automotive News, June 12, 2000.

[4] *New China News Agency*, April 15, 2000.

[5] "How WTO Membership Could Affect China's Auto Industry," op. cit.

[6] "Shanghai Auto Imports Cruising," *ChinaOnline*, June 27, 2000.

[7] China CarGuide Corporation, http://www.carguide.com.cn, Toyota owns 51% of Daihatsu Motor Corporation, whose minibuses and Charade mini cars have become ubiquitous in Beijing.

1999, the U.S. exported only 1,700 new passenger vehicles and light trucks to China.[8] (See **Table 1** & **Table 2**.)

General Motors (GM) is the leading American automobile manufacturer in China, with plans to capture 15% of the sedan market by 2005. Its joint venture facility in Shanghai is expected to build 50,000 Buicks in 2000, or about half of China's luxury cars. Shanghai-GM has also introduced a minivan. The plant exceeded expectations in 1999, when it reportedly sold 20,000 Buicks (priced at $40,000), after less than eight months in operation, and posted a $75 million profit.[9]

In the late 1990s, Beijing Jeep (Chrysler) built 20,000 Cherokees per year. Sales have reportedly begun to decline due to competition from the Mitsubishi Pajero and other more fuel-saving vehicles. The company has plans to produce a relatively inexpensive sport utility vehicle.[10] Other major foreign auto companies in China include Audi (VW), Citroen, and Honda, which is producing Accords in Guangzhou. Recently-announced projects include a Toyota joint venture with the capacity to build 120,000 small cars annually and a Hyundai joint venture with plans to produce 300,000 units per year.

Projected Growth

China has been projected to represent 25% of global demand for new cars over the next ten years. According to U.S. auto industry estimates, China's motor vehicle market could reach 7 million units annually by 2007 and the U.S. level of 16 million units per year by 2025.[11] Passenger cars for both companies and families will make up an increasing proportion of the overall vehicle market. Analysts at Shanghai-GM claim that per capita incomes in some of the coastal cities have reached the "threshold" of $3,000 that makes cars affordable.[12] An industry specialist predicts that in the foreseeable future, domestic producers will not be able to keep up with rising demand, and imports will grow.[13]

Exports of Chinese cars to the United States are likely to remain low. Currently, China exports almost no family-size passenger vehicles to the United States. In 1999, China exported 266 golf carts to the U.S. In addition, Americans purchased from China 667 specially designed small vehicles and 1,649 gasoline-powered vehicles with engine capacity under 1000cc's (valued at less than $600 per unit).[14] Korean automobile companies are aiming to be the third major competitor in the U.S. market after Japan and Germany; Korean auto trade experts do not foresee a Chinese threat to their U.S. and European market shares. An American industry specialist suggests that as the Chinese market becomes saturated in the long term, Chinese manufacturers may seek markets in other developing countries rather than the U.S.[15]

[8] U.S. Department of Commerce.

[9] Clay Chandler, "GM's China Bet Hits Snag: WTO," *Washington Post*, May 10, 2000, p. E1.

[10] Paul Mooney, "Historic 'Heroic': Beijing Jeep Rolls out SUV," *China Online*, June 13, 2000.

[11] Lawrence B. Zahner, "GM Aims To Grab 15% of China's Growing Auto Market by 2005," *Korea Herald*, December 8, 1999.

[12] Chandler, op. cit. China's per capita GDP in purchasing power parity (PPP) terms is $4,228; China's nominal per capita GDP is $790. PPP factors in cost of living. See CRS Issue Brief IB98014, *China's Economic Conditions*, by Wayne M. Morrison.

[13] Automotive Trade Policy Council, Washington, D.C.

[14] United States International Trade Commission, U.S. Department of Commerce.

[15] "China's Entry into WTO Likely To Hurt Korea's Long-Term Trade," *Korea Herald*, November 17, 1999; Automotive Trade Policy Council, Washington, D.C.

Table 1. U.S. Vehicle Exports to China
(1000 dollars)

Commodity	1995	1996	1997	1998	1999
Ambulance/Hearse/Prison Van	87	236	371	195	288
Buses and Vans	1,543	5,225	697	214	28
Chassis with Engines	19	11	0	117	4,659
Light Trucks	12,187	915	3,072	420	517
Motor Homes	917	228	254	62	50
New Medium and Heavy Trucks	4,852	6,860	37,465	6,040	2,236
New Passenger Vehicles	44,160	8,624	14,851	14,119	5,106
Used Passenger Vehicles	3,374	3,889	7,658	5,942	2,077
Used Road Tractors	0	0	123	169	150
Total	67,122	25,989	64,492	27,279	15,112

Source: Motor Vehicle Division, U.S. Department of Commerce

Table 2. U.S. Vehicle Exports to China
(in units)

Commodity	1995	1996	1997	1998	1999
Ambulance/Hearse/Prison Van	3	7	8	4	6
Buses and Vans	76	120	17	44	4
Chassis with Engines	2	2	0	1	398
Light Trucks	738	72	125	31	25
Motor Homes	34	10	6	1	2
New Medium and Heavy Trucks	78	97	1,761	131	33
New Passenger Vehicles	2,612	467	543	620	1,668
Used Passenger Vehicles	364	369	536	444	122
Used Road Tractors	0	0	5	4	2
Total	3,907	1,144	3,001	1,280	2,260

Source: Motor Vehicle Division, U.S. Department of Commerce

Vehicle Parts and Accessories

China's accession to the WTO could benefit U.S. parts and accessories suppliers. Lower tariffs on both autos and parts and the elimination of domestic content requirements may raise demand for imported parts. An auto industry specialist suggests that low productivity and quality would likely reduce the price-competitiveness and attractiveness of many locally-made parts compared to imported ones.[16] Chinese industry analysts argue that only two Chinese manufacturers, First Auto

[16] Harry Stoffer, "Suppliers Are Early Winners in China Deal," *Automotive News*, November 22, 1999; Automotive

Works and Shanghai Automotive, can make major automotive components that meet international standards.[17] Michigan exported $264 million worth of goods to China in 1998, mostly machinery and auto parts. Half of the 400 companies in the state that do business with China supply the new GM plant in Shanghai. General Motors estimates that it will export $2 billion in vehicles and parts to China in the next five years if PNTR status is approved.[18]

Other trends indicate that the Chinese parts industry is becoming more competitive. Chinese exports of vehicle parts and accessories to the United States have been increasing steadily. The United States runs a trade deficit in auto parts with several countries, including China. (See **Table 3**.) As efficiency and quality improve, local parts may become more appealing despite a reduction in tariffs on imported ones. For example, a Shanghai-GM executive stated that the company plans to increase locally sourced components from 40% to 80%.[19] Much of Chinese output in parts for export and domestic auto production involves foreign investment. Toyota has two dozen parts facilities in China. Delphi Automotive Systems, which has built ten plants in China, has become a leading supplier of parts to some of China's major auto makers.[20]

Table 3. U.S. Exports/Imports of Automotive Parts, Top Ten Trading Partners

(1000 dollars)

Country	1997		1998		1999	
	Exports	Imports	Exports	Imports	Exports	Imports
Canada	24,386,570	13,833,572	25,297,880	14,712,138	29,643,478	16,934,110
Mexico	9,582,179	13,324,020	9,501,618	14,481,252	9,271,320	16,767,508
Japan	2,312,161	11,856,106	2,138,740	11,878,906	1,892,879	12,775,546
Germany	1,005,596	2,625,685	1,018,942	3,113,780	949,532	3,451,295
United Kingdom	752,233	808,571	843,828	1,030,808	1,190,634	1,118,410
Brazil	612,793	1,233,233	816,020	1,240,407	428,297	1,359,552
France	296,400	961,092	268,185	1,093,982	280,956	1,302,583
Korea	660,708	664,095	364,357	761,894	597,206	919,452
China	310,771	795,317	132,048	1,036,856	251,000	1,284,063

Source: U.S. Department of Commerce

Trade Policy Council, Washington, D.C.

[17] "How WTO Membership Could Affect China's Auto Industry," op. cit. China reportedly has about 2,500 parts makers, mostly small-scale, inefficient, and not technologically adept.

[18] Mike Magner, "China Trade Status Battle Affects Michigan Businesses," *The Grand Rapids Press*, May 7, 2000, p. E1.

[19] Shanghai, December 1999.

[20] "Shanghai Auto Parts Producers Expect To Succeed in Long Run," *China Business Information Network*, December 10, 1999.

Prospects for U.S. Business

Rising Chinese Demand for Imported Cars

China's accession to the WTO would lower tariffs and prohibit other trade barriers, eliminate domestic content requirements, allow foreign financing, and grant foreign joint-venture partners greater decision-making powers and control over distribution. WTO provisions would make imported products more economical to the rising Chinese middle class and investment more profitable for foreign companies. An indication of the likely rise in imports is the estimated 30% drop in car sales in China since the U.S.-China WTO agreement was signed. This decline has reportedly been triggered by the anticipation of cheaper imports once China accedes to the WTO.[21] According to industry experts, companies that already build cars in China have advantages of name recognition, existing distribution networks, and government contacts that would facilitate sales.

Possible Impediments to Greater Imports

Political and economic obstacles may hamper production and constrain foreign car sales in China. Excessive bureaucratic regulations and fees and low productivity have made many joint venture projects unprofitable.[22] Even successful foreign companies may face formidable competition from Chinese manufacturers in the long term. The PRC government welcomes foreign investment as a means to develop a domestic automobile industry that can compete on its own. The state, which owns a significant share of the largest car manufacturers, provides capital to the domestic companies and requires foreign partners to transfer cutting-edge technology.

Economic and other factors may impede auto sales in general and demand for imported cars in particular. Myriad taxes and fees artificially raise the cost of vehicles – both foreign and domestic – beyond the reach of most consumers. Auto services, including maintenance, parking, insurance, and gasoline distribution, remain underdeveloped, which discourages auto purchases. Some Chinese experts suggest that for the next ten to fifteen years, sedans will be unaffordable and unsuitable to Chinese peasants, who comprise three-quarters of the national population.[23] State agencies and corporations are required to buy domestically-produced vehicles. Some provinces and municipalities have favored cars produced in their own localities.[24] Shanghai, for example, has required its taxi fleets to buy Shanghai-made Volkswagens and charged additional licensing fees for cars made outside the municipality.

[21] Craig S. Smith, "A Buyer's Guide to China's Latest Cars," *New York Times,* April 16, 2000, p. A18.

[22] Chester Dawson, "Toyota's China Play," *Far Eastern Economic Review*, June 8, 2000.

[23] "How WTO Membership Could Affect China's Auto Industry," op. cit.

[24] These include joint-venture products. Craig S. Smith, "Global Corporate Report: WTO Membership for China Threatens Inefficient State-Owned Auto Makers," *Wall Street Journal*, May 10, 1999, p. 6; "China Plans To Protect Local Car Makers after WTO," *ChinaOnline,* December 7, 1999.

Author Information

Thomas Lum
Specialist in Asian Affairs

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